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In the

Supreme Court of the United States

OCTOBER TERM, 1976

NATIONAL GEOGRAPHIC SOCIETY,

Appellant,

vs.

BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA,

Appellee.

On Appeal From The Supreme Court Of The State Of California

BRIEF AMICUS CURIAE ON BEHALF OF DIRECT MAIL/MARKETING ASSOCIATION, INC. URGING REVERSAL

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QUESTIONS PRESENTED

This case presents questions which go to the very heart of the constitutional requirement for an orderly system of taxation of interstate commerce that does not seriously impede the free flow of commerce. The questions necessarily include the following:

1. Whether the adoption of the "slightest presence" test as formulated by the California Supreme Court violates the constitutional prohibition against impediment

to the free flow of commerce between the 50 states with respect to retail sales made by interstate mail.

2. Whether the adoption of the "slightest presence" test by the California Supreme Court effectively discards the "dissociation" test conflicting with the minimum nexus requirements set forth by this Court in *American Oil Co.* v. *Neill et al,* 380 U.S. 451 (1965) and other cases decided by this Court.

INTEREST OF AMICUS CURIAE

The interest of Direct Mail/Marketing Association, Inc. as *amicus curiae* is set forth in the Association's motion for leave to file this brief *amicus,* to which motion this brief is annexed.

ARGUMENT

The Imposition Of Use Tax Collection Liability Upon An Out-Of-State Mail Order Seller Based Upon The "Slightest Presence" Of The Seller Within The Taxing State Is In Violation Of The Due Process Clause And The Commerce Clause Of The United States Constitution.

Any corporation doing an interstate business is faced with a barrage of taxes of various kinds asserted by states other than its own, and must frequently consider a demand from a state thousands of miles away. In attempting to assess the probable validity of this demand, the businessman and his counsel need guidance. This is especially true of the out-of-state mail order seller whose only selling activity is through the use of the U.S. mails.

The number and kind of interstate businesses are described in the June 15, 1964 published Report on "State Taxation of Interstate Commerce" (here called "Subcommittee Report") by the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary of the House of Representatives. It concluded that not fewer than 120,000 firms were engaged in interstate commerce, and that the number could very well be 200,000. Of these, ". . . a majority appear to be companies with less than one million dollars of annual sales, and about half appear to have fewer than twenty employees. Very substantial proportions have annual sales of less than $500,000 and fewer than ten employees" (Subcommittee Report, Page 75). The overwhelming majority have places of business in only one State. Yet even among the smallest manufacturers, the typical interstate company has markets at some distance from its home plant, and ships its products into several states (Ibid, Page 76).

These businesses are faced with a nation-wide network of complex taxes. Forty-five states and the District of Columbia require out-of-state sellers to collect use taxes on sales made in the state, with many tests for determining liability of the out-of-state seller to collect such taxes. Local taxes must also be added to this number of tax jurisdictions which impose varying tests for collection liability.

To say that these tests are something less than definite is to understate the matter. As the Subcommittee Report referred to above summarized the matter, "In the majority of States neither statute nor regulation furnishes a sufficient description of the circumstances in which a corporation is liable to enable it easily to determine whether it is subject to tax liability." (Report, Page 142). Truly, it would require a staff of accountants and lawyers to attempt to bring some order out of the statutory chaos.

But the Congressional Subcommittee found that the "typical interstate business is not a corporate giant with a large tax department and refined electronic data-processing equipment." (Report, Page 75). Quite the contrary: "The vast majority of multistate businesses are not presently equipped to deal with State and local taxation on a very complex level. The typical interstate company is characterized by substantial use of hand work in its tax accounting, little in the way of professional tax assistance, and an almost complete absence of systematic tax planning. Sophisticated systems of accounting and tax handling occur only among the very large" (Report, Page 87).

This Court anticipated the problem in *National Bellas Hess, Incorporated* v. *Department of Revenue,* 386 U.S. 753 (1967) wherein it stated:

> "Indeed, it is difficult to conceive of commercial transactions more exclusively interstate in character than the mail order transactions here involved. And if the power of Illinois to impose use tax burdens upon National were upheld, the resulting impediments upon the free conduct of its interstate business would be neither imaginary nor remote. For if Illinois can impose such burdens, so can every other State, and so, indeed, can every municipality, every school district, and every other political subdivision throughout the Nation with power to impose sales and use taxes. The many variations in rates of tax, in allowable exemptions, and in administrative and recordkeeping requirements could entangle National's interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose 'a fair share of the cost of the local government.'"

If the "slightest presence" test of the California Supreme Court is to be applied, mail order sellers would be subjected not only to state and local use tax collection, but also state and local gross receipts taxes, gross income and flat fee license taxes.

It is respectfully suggested that in the instant case, the California Supreme Court has created further uncertainty in a field of law already noted for its amorphous quality.

This uncertainty may result from a kind of oversophistication on the part of both the Bench and the Bar, which takes the form of a constant re-examination and refinement of opinions enunciated by this Court.

In *Colonial Pipeline Company* v. *Traigle,* 421 U.S. 100 (1975), this Court took note of the need for clear legal distinctions in the area of taxation of interstate commerce in stating that present distinctions fail to provide what

taxpayers and the lawyers who advise them have a right to expect, namely, a firm and solid basis of differentation between that which runs afoul of the Commerce Clause and that which is consistent with that Clause.

In our contemplation of the thousands of words which make up those opinions, we tend to forget the Constitution itself, and the basic principles of Constitutional Law which are dictated by it.

We must begin here with the principle that the Commerce Clause prohibits state taxes, however measured, upon the privilege of carrying on a business that is exclusively interstate in character. When the contention is made that a state tax is invalid for this reason, the first proper area of inquiry is simply whether or not the business is in fact interstate in character, and whether the tax is one on the privilege of carrying on that business. *Spector Motor Service* v. *O'Connor,* 340 U.S. 602, 609 (1951).

However, it is not constitutionally sufficient to stop at this point and apply rules based upon this consideration alone. In considering the issue, both the Due Process Clause and the Commerce Clause must be applied. As this Court stated in *National Bellas Hess, Inc.* v. *Department of Revenue* (supra):

"These two claims (Due Process and Burden on Interstate Commerce) are closely related."

In considering both claims, this Court said at page 756:

> "For the test whether a particular state exaction is such as to invade the exclusive authority of Congress to regulate trade between the States, and the test for a State's compliance with the requirements of due process in this are similar (citation omitted).

> As to the former, the Court has held that 'State taxation falling on interstate commerce . . . can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys' (citation omitted). And in determining whether a state tax falls within the confines of the Due Process Clause, the Court has said that the 'simple but controlling question is whether the state has given anything for which it can ask return.' (citations omitted). The same principles have been held applicable in determining the power of a state to impose the burdens of collecting use taxes upon interstate sales. Here, too, the Constitution requires 'some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.' (citations omitted)."

And as stated by the Court in *Miller Bros. Co.* v. *Maryland,* 347 U.S. 34 (1954):

> "The collection of the use tax from inhabitants is a difficult administrative problem, and if out-of-state vendors can be compelled to collect it and remit it to the taxing state, it simplifies administration. But this raises questions of great importance to particular taxpayers, to the course of commercial dealing among the states and as an appropriation by other states of tax resources properly belonging to the state where the event occurs."

Thus, it is clear that a test based upon the "slightest presence" in a state, no matter how inconsequential or no matter what the degree of relationship to the activity sought to be taxed may be, cannot prevail when evaluated in the light of the requirements of either the Commerce Clause or the Due Process Clause. This Court has consistently refused to equate "minimum" with "slightest," for in the one a certain quantum and character of activity

is required whereas in the other, any activity may be the actuating mechanism for tax collection liability. See *Miller Brothers Company* v. *Maryland* (Supra), *Connecticut General Life Insurance Company* v. *Johnson*, 303 U.S. 77 (1928), *Norton Company* v. *Department of Revenue*, 340 U.S. 534 (1951).

In the case of out-of-state mail order sellers, the presence of purchasing agents in a state, or the printing of a catalog in a state, or the purchase of business insurance in a state, or the attendance by corporate officers at a seminar in a state, or the presence of a delivery vehicle in the state, or the use of a local post office in a state, or the one-time use of commercial banking facilities in a state could create a "slightest presence" no matter how temporary or non-recurring such activities may be in that state. Such activities are not directly related to sales activities in that state but as with all business activities, the sum and substance of all activities, are either directly or indirectly related. It is submitted that the only constitutionally valid test of "presence" for the purpose of conferring use tax collection liability is a continuous activity directly related to the activity sought to be taxed.

It is further submitted that the activities recited herein, while properly classed as business activities, do not constitute such a continuous and directly related presence as to confer use tax collection jurisdiction on the state wherein such unrelated activities are performed.

The "Slightest Presence" Test Effectively Discards And Conflicts With The "Dissociation" Doctrine Adopted By This Court As A Test Of Minimum Nexus For Imposition Of Tax Liability.

The problem of the existence of a jurisdictional nexus is critical to the thousands of businesses engaged in interstate selling through the use of the U.S. mail. The statutory nexus requirements for determining under what circumstances an out-of-state seller will be required to collect a use tax cover a wide range and require an affirmative, clear and concise delineation in order to comply with the constitutional requirements of the Commerce and Due Process Clauses.

This Court has wisely adopted a basis upon which jurisdictional nexus can be reached, and in so doing has clearly set forth those activities that do not confer such jurisdiction. In-state activities of a seller that are not sales related are said to be 'dissociated" from the out-of-state sales and cannot provide the constitutionally needed nexus for taxing such sales. See *Norton Company* v. *Department of Revenue* (Supra), *American Oil Company* v. *Neill* (Supra), and *Connecticut General Life Insurance Company* v. *Johnson* (Supra).

The doctrine of "dissociation" is firmly rooted in the decisions of this Court, beginning with the *Connecticut General Life Insurance Company* case. In that case, California was attempting to tax out-of-state transactions of reinsurance not specifically related to any of the taxpayer's activity in the state.

The State of California imposed an annual tax on every insurance company, doing business within the State, of 2.6% of the amount of the gross premiums received upon its business done in the State less return premiums and

reinsurance in companies or associations, authorized to do business in the State. Taxpayer in this case was a Connecticut corporation, admitted to do an insurance business in California. In addition to that business, conducted in the State, it made contracts with other insurance corporations, likewise licensed to do business in California, reinsuring them against loss on policies of life insurance, effected by them in California and issued to California residents. But these reinsurance contracts were entered into in Connecticut, where the premiums were paid and losses were payable.

The Supreme Court of California held that the measure of the California tax also included in the premiums on Taxpayer's reinsurance policies effected and payable in Connecticut. This Court reversed the decision of the Supreme Court of California on the ground that the reinsurance business of taxpayer was not connected with the local insurance business that it did in California for the following reason:

> "Appellant, by its reinsurance contracts, undertook only to indemnify the insured companies against loss upon their policies written in California. The reinsurance involved no transactions or relationship between appellant and those originally insured, and called for no act in California (citations omitted). Apart from the facts that appellant was privileged to do business in California, and that the risks reinsured were originally insured against in that state by companies also authorized to do business there, California had no relationship to appellant or to the reinsurance contracts. No act in the course of their formation, performance or discharge, took place there. The performance of those acts was not dependent upon any privilege or authority granted by it, and California laws afforded to them no protection.
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> "The tax cannot be sustained either as laid on property, business done, or transactions carried on within the state, or as a tax on a privilege granted by the state."

Subsequently, in *Norton Company* v. *Department of Revenue* (Supra), this Court again affirmed the doctrine of "dissociation" stating at page 537 that:

> "Unless some local incident occurs *sufficient* to bring the transaction within its taxing power, the vendor is not taxable." (Italics added).

In *Norton,* this Court established the rule that taxation of an out-of-state company on local sales can only be avoided by showing that particular transactions are "dissociated" from the local business and are interstate in nature. In the determination of the interstate activities involved, this Court stated on page 539 that:

> "The only items that are so clearly interstate in character that the State could not reasonably attribute their proceeds to the local business are orders sent directly to Worcester by the customer and shipped directly to the customer from Worcester."

Thus, it is clearly established that the local incident necessary to confer jurisdictional nexus must be sufficient in nature, not merely a scintilla of activity as the California Supreme Court holds in asserting its doctrine of "slightest presence" and further, this Court recognizes that local and interstate activities must be "dissociated" for purposes of imposing tax liability.

In *American Oil Co.* v. *Neill* (Supra) this Court reaffirmed its position that imposition of a tax upon a dealer entirely "dissociated" from any in-state activities violated the Due Process Clause. The question again was the suffi-

ciency of the relation of in-state activities to those activities sought to be taxed. On page 457, this Court stated that:

> "More than once this Court has struck down taxes directly imposed on or resulting from out-of-state sales which were held to be *insufficiently related* to activities within the taxing State. (Citations omitted) (Italics added).

Citing cases dealing with a use tax, a gross receipts tax and a sales tax, this Court said on page 458 that:

> "These cases have also firmly established the doctrine that when a tax is imposed on an out-of-state vendor, 'nexus' between the taxing State and the taxpayer is the outstanding prerequisite on state power to tax. Consistent with this requirement there must be 'some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.' (Citation omitted). Granted that when a corporation, pursuant to permission given, enters a State and proceeds to do local business the 'link' is strong. In such instances there is a strong inference that it exists between the State and transactions which result in economic benefits obtained from a source within the State's territorial limits. *The corporation can, however, exempt itself by a clear showing that there are no in-state activities connected with out-of-state sales. In such instances, the transactions are said to be 'dissociated from the local business.' Norton Co.* v. *Department of Revenue,* supra, at 537, and therefore may not, consistent with due process, be taxed." (Italics added).

What is important according to the ruling of this Court in this case is a determination of whether the in-state activities contributed in any way to the procurement or performance of the contract. It is respectfully submitted

that this requirement of contribution to procurement or performance seeks a direct relationship with the activities to be taxed and does not, as the "slightest presence" doctrine formulated by the California Supreme Court would, permit imposition of use tax collection liability on the basis of any activity in the taxing State. To the interstate mail order seller, this issue is vital. To permit imposition of use tax collection liability on the basis of any in-state activity, however remote and unrelated, would destroy the constitutional guarantees of due process and freedom from impediment of interstate commerce which have been consistently upheld in this Court in its decisions establishing the "dissociation" doctrine and requiring minimum nexus.

Conclusion

The growth of our society has placed increasing demands on our State and local governments. Population expansion, particularly in our cities and towns, has burdened local jurisdictions with demands for increased public services—in the form of schools, roads, sewers, fire and police protection. State and local governments, in meeting these demands have had to open new resources of revenue, the proliferation of which have seriously threatened an orderly system of interstate commerce operating under time-honored concepts with respect to taxation of interstate commerce that have been established by this Court over the years.

It is respectfully submitted that the need for revenues does not justify an unconstitutional means to obtain such revenues and that however powerful those needs, States

and their local governments may not set aside the basic requirements of the Constitution with respect to the jurisdictional reach of the States and their local governments. The doctrine of "dissociation" enunciated by this Court lays down guidelines upon which this jurisdictional reach may be extended to the interstate mail order seller and the replacement of this sound doctrine by adoption of a new theory of "slightest presence" cannot stand the constitutional tests required by the Commerce and Due Process Clauses. It is respectfully submitted that on the basis of arguments presented herein, the "slightest presence" doctrine as adopted by the California Supreme Court for application to the interstate mail order sellers is a nullity as it conflicts with the most explicit constitutional inhibitions as heretofore set forth by this Court.

Respectfully submitted,

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